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INTERCITY PASSENGER RAIL

Outlook for Improving Amtrak's Financial Health

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Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to testify today on Amtrak's financial condition. Less than a year ago, we appeared before this Subcommittee to discuss Amtrak's financial problems.[1] At that time, we said that Amtrak was in a very precarious financial position. Amtrak itself raised the specter of a corporate bankruptcy in 1997.[2] We are here today to report that Amtrak continues to be in a very precarious position and will remain so for the immediate future. We base this assessment on Amtrak's financial performance last year and during the first quarter of this fiscal year; challenges that Amtrak will face in improving its financial health; and the potential impact that recently enacted legislation may have on Amtrak's financial condition. In summary:

- Amtrak's financial condition continues to deteriorate. Although Amtrak has been able to reduce its net losses (total expenses less total revenues) from about \$892 million in fiscal year 1994 (in 1997 dollars) to about \$762 million in fiscal year 1997, the 1997 loss would have been \$63 million higher were it not for one-time increases in revenue from the sales of real estate and access rights for telecommunications. Prospects for fiscal year 1998 are not bright. In March 1998, Amtrak projected that its net loss for fiscal year 1998 could be about \$845 million—about \$56 million more than planned.

- Amtrak will continue to face challenges in improving its financial health. Amtrak hopes to improve its financial health by increasing revenues through such actions as expanding mail and express service (delivery of higher-value, time-sensitive goods) and instituting high-speed rail service between New York City and Boston. However, Amtrak has had to substantially scale back its net revenue projections for express business, and positive net income from the high-speed rail program will not occur for another 2 years. Amtrak does not currently plan to reduce routes, even though only one of its routes—the Metroliner service between Washington, D.C., and New York City—makes money. Instead it plans to

[1]Transportation Financing: Challenges in Meeting Long-Term Funding Needs for FAA, Amtrak, and the Nation's Highways (GAO/T-RCED-97-151, May 7, 1997). See also, DOT's Budget: Management and Performance Issues Facing the Department in Fiscal Year 1999 (GAO/T-RCED/AIMD-98-76, Feb. 12, 1998); and Intercity Passenger Rail: Amtrak's Financial Crisis Threatens Continued Viability (GAO/T-RCED-97-147, Apr. 23, 1997).

[2]See our report entitled Intercity Passenger Rail: Issues Associated With a Possible Amtrak Liquidation (GAO/RCED-98-60, Mar. 2, 1998) for a discussion of the expected financial and other effects if Amtrak were to undergo liquidation.

fine-tune its route network and conduct a comprehensive market analysis.

- Federal funding and recently enacted reforms will not solve Amtrak's financial problems. Although the Taxpayer Relief Act of 1997, fiscal year 1998 capital appropriations, and the President's proposed fiscal year 1999 budget, if enacted, will provide Amtrak with historic levels of capital support, this support will fall short of Amtrak's identified capital needs by about $500 million. In addition, Amtrak plans to use $1.8 billion of the $2.8 billion in requested federal capital grant funds to pay maintenance expenses between fiscal years 1999 and 2003. The use of funds for this purpose would substantially reduce the remaining level of funds available to acquire new equipment or make the capital improvements necessary to reduce Amtrak's costs and/or increase revenues. Therefore, such use will have a negative impact over the long term. Furthermore, the Amtrak Reform and Accountability Act of 1997 significantly changed Amtrak's operations; but these reforms will provide few, if any, immediate financial benefits.

Background

Amtrak was created by the Rail Passenger Service Act of 1970 to operate and revitalize intercity passenger rail service. Prior to Amtrak's creation, such service was provided by private railroads, which had lost money, especially after World War II. The act, as amended, gave Amtrak a number of goals, including providing modern, efficient intercity passenger rail service; giving Americans an alternative to automobiles and airplanes to meet their transportation needs; and minimizing federal operating subsidies. Through fiscal year 1998, the federal government has provided Amtrak with over $20 billion in operating and capital subsidies, excluding $2.2 billion from the Taxpayer Relief Act.

In December 1994, at the request of the administration, Amtrak established a goal of eliminating federal operating subsidies for Amtrak by 2002. To meet this goal and respond to continually growing losses and a widening gap between operating deficits and federal operating subsidies, Amtrak developed strategic business plans. These plans have attempted to increase revenues and control costs through such actions as expanding mail and express service and adjusting routes and service frequency. Amtrak also has restructured its organization into strategic business units.

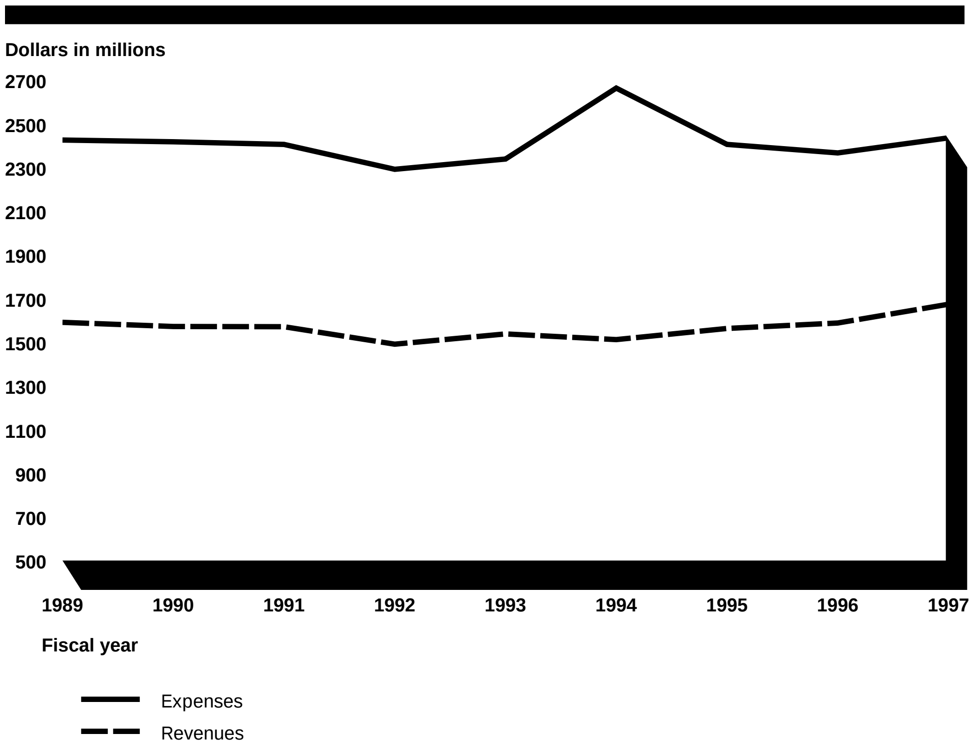
The Congress provided additional financial assistance to Amtrak in the Taxpayer Relief Act of 1997, enacted in August 1997. This act makes a total of about $2.2 billion available to Amtrak in 1998 and 1999 to acquire capital improvements, pay certain equipment maintenance expenses, and pay principal and interest on certain debt, among other things. In addition, the Amtrak Reform and Accountability Act of 1997, enacted in December 1997, makes certain reforms to Amtrak's operations. These reforms include, among other things, (1) eliminating current labor protection arrangements on May 31, 1998; (2) repealing the ban on contracting out nonfood and beverage work; and (3) placing a $200 million cap on the amount of liability claims that can be paid as the result of an Amtrak accident.

Amtrak's Financial Condition Continues to Deteriorate

Amtrak's financial condition has continued to deteriorate despite its efforts over the past 4 years to reduce losses. While Amtrak has reduced its net losses from about $892 million in fiscal year 1994 (in 1997 dollars)[3] to $762 million in fiscal year 1997, it has not been able to close the gap between total revenues and expenses. (See fig. 1.) For example, while intercity passenger-related revenues grew by about 4 percent last year, intercity passenger-related expenses grew by about 7 percent. Notably, the net loss for fiscal year 1997 would have been much greater if Amtrak had not earned about $63 million, primarily from the one-time sales of real estate and telecommunications rights-of-way in the Northeast Corridor.

[3]Unless otherwise noted, information on financial condition and performance was provided by Amtrak and was not independently verified. The net loss for fiscal year 1994 excludes a one-time charge of $261 million (in 1997 dollars) for accounting changes, restructuring costs, and other items.

Figure 1: Revenues and Expenses, Fiscal Years 1989-97

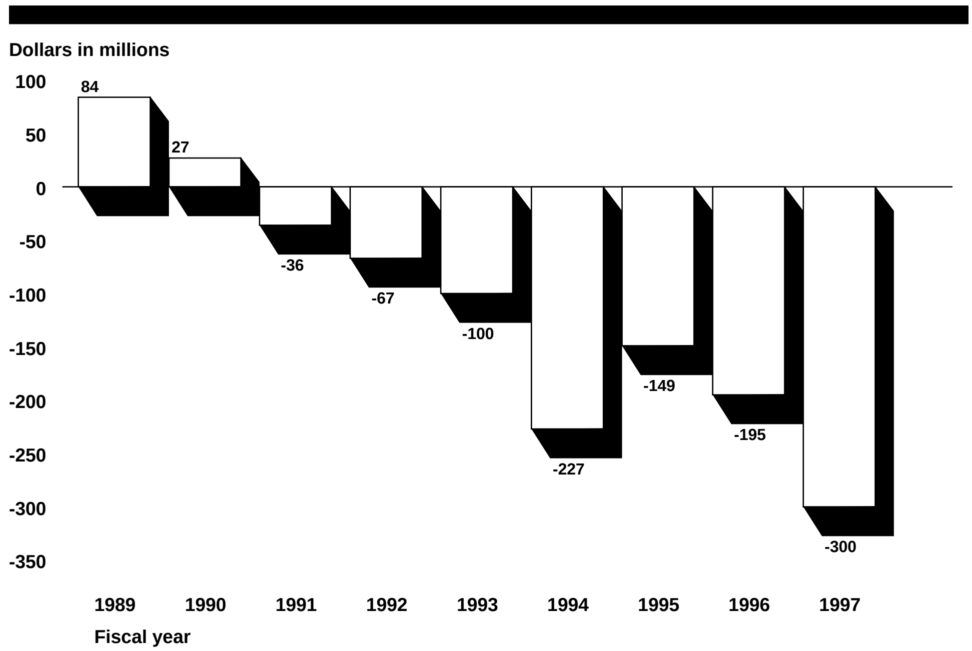


Note: Amounts are in 1997 dollars.

Source: GAO's analysis of Amtrak's data.

Amtrak's net loss for fiscal year 1998 will likely be substantially worse than in 1996 and 1997. In March 1998, Amtrak projected that the net loss for this year will be about $845 million, or $56 million more than budgeted. Amtrak's financial deterioration can be seen in other measures as well. For example, Amtrak's working capital—the difference between current assets and current liabilities—generally declined between fiscal years 1995 and 1997, from a deficit of $149 million to a deficit of $300 million. As figure 2 shows, at the end of fiscal year 1997, Amtrak's working capital was the lowest it had been over the last 9 years. Declining working capital jeopardizes a company's ability to pay its bills as they come due. The decline in working capital reflects an increase in accounts payable, short-term debt, and capital lease obligations, among other items.

Figure 2: Amtrak's Working Capital Surplus/Deficit, Fiscal Years 1989-97



Note: Amounts are in nominal dollars.

Source: GAO's analysis of Amtrak's data.

Amtrak's poor financial condition has also affected its cash flow and its need to borrow money to make ends meet. In fiscal year 1997, Amtrak had to borrow $75 million to meet its operating expenses. The prospects in fiscal year 1998 are worse. Amtrak originally planned a cash-flow deficit of $100 million in fiscal year 1998; however, in January 1998, Amtrak increased this estimate to $200 million.[4] This projected increase is primarily due to (1) reductions in expected revenues from Amtrak's pilot express program ($47 million); (2) a liability for the wage increases provided by Amtrak's recent agreement with the Brotherhood of Maintenance of Way Employees ($35 million);[5] and, (3) an increase in accounts payable that resulted from deferring fiscal year 1997 payables to

[4]As of mid-March 1998, Amtrak had $150 million of its $170 million in short-term lines of credit available to help meet cash-flow deficits.

[5]This $35 million reflects Amtrak's estimate of the cost in fiscal year 1998 of extending the Brotherhood of Maintenance of Way Employees labor settlement to Amtrak's 12 other labor unions. Amtrak is in the process of negotiating with the other unions.

fiscal year 1998 ($16 million). Amtrak began borrowing in February 1998 to make ends meet.

Improving Amtrak's Financial Health Presents Challenges

Amtrak will continue to face challenges to its financial health. Despite efforts to improve revenues and cut costs, the railroad continues to lose more money than it planned. This situation may get worse. Amtrak's recent agreement with the Brotherhood of Maintenance of Way Employees is expected to increase Amtrak's fiscal year 1998 labor costs by between $3 million to $5 million. According to Amtrak, extending this type of settlement to all of its labor unions could cost between $60 million and $70 million more each year than is currently planned, from fiscal years 1999 through 2002.[6] Amtrak's plans to reduce its financial losses by "growing" its way to financial health—that is, increasing revenues, rather than cutting train routes—may also encounter difficulty. These plans depend, at least in part, on expanding mail and express services. However, Amtrak's efforts to increase its express business have been frustrated and it has had to reduce anticipated revenues in its express pilot program by $47 million.[7] As a result, in January 1998 Amtrak increased its projected overall loss[8] for fiscal year 1998 from $52 million to $99 million. Another Amtrak initiative—establishing high-speed rail service between New York City and Boston—also will not provide immediate financial benefits. In establishing high-speed rail transportation between these two cities, Amtrak expects to decrease travel time from 4-1/2 hours to 3 hours and significantly increase revenue and ridership. Amtrak's goals are for the high-speed rail program to begin providing positive net income in fiscal year 2000.

Amtrak will also continue to find it difficult to take actions to reduce costs, such as making route and service adjustments. During fiscal year 1995, Amtrak was successful in reducing and eliminating some routes and saving an estimated $54 million. In fiscal year 1997, Amtrak was less successful in taking such actions. Amtrak does not currently plan to reduce any more routes. Instead, it plans to fine-tune its route network. For example, in February 1998, Amtrak added a fourth train per week

[6]This is net of any one-time payments or productivity increases or efficiency gains negotiated with the unions.

[7]In addition, the Surface Transportation Board has been asked to rule on whether a freight railroad must make its tracks and facilities available to Amtrak for express service. An adverse ruling could further reduce revenue opportunities. Amtrak has reduced its anticipated net revenues from express service from about $75 million annually to about $27 million annually after fiscal year 1998.

[8]Overall loss is the same as net loss, except the federal operating support received and noncash items (such as depreciation) are excluded. Amtrak refers to overall loss as its "budget result."

between Chicago and San Antonio on the Texas Eagle route, in part to accommodate expanded mail and express business. Amtrak is also planning to begin daily passenger rail service between Los Angeles and Las Vegas by January 1999.

In explaining the rationale for attempting to increase revenues through fine-tuning Amtrak's routes rather than through cutting back on service, Amtrak and Federal Railroad Administration (FRA) officials pointed to Amtrak's mission of maintaining a national route system. They noted that such a system will consist of routes with a range of profitability, including poorer-performing routes that provide needed linkages to better-performing routes. Furthermore, poorer-performing routes may provide public benefits, such as serving small cities and rural areas. These officials stressed that cutting the routes with the worst performance could damage the national network and cause the loss of revenue on connecting routes. Amtrak has just begun a market analysis that could result in several alternatives for a national intercity passenger rail network.

The decision to make route adjustments is a difficult one, even though Amtrak's data show that only one of the railroad's 40 routes (Metroliners between Washington, D.C., and New York City) covers all its operating costs.[9] For the remaining 39 routes, Amtrak loses an average of $53 for each passenger. Amtrak data show that it loses over $100 per passenger on 14 of these routes, and only 5 routes covered their train costs in fiscal year 1997. However, Amtrak encounters opposition when it proposes to discontinue routes because of the desire by a range of interests to see passenger train service continued in potentially affected communities. In addition, Amtrak maintains that every route that covers its variable costs (costs of running trains) makes a contribution toward its substantial fixed costs. Finally, simply pruning Amtrak's worst-performing routes could exacerbate Amtrak's financial condition because eliminating one route is likely to affect ridership on connecting routes that are perhaps performing better.

[9]The costs include the costs of running trains (e.g., fuel and train crew); route costs (e.g., costs to maintain stations); and allocated system costs (overhead).

Federal Funding and Reform Legislation May Not Meet Amtrak's Financial Needs

As a result of the Taxpayer Relief Act and funds requested through the appropriations process, record amounts of federal funds could be available to fund Amtrak's capital improvement needs. However, Amtrak projects that it will still be short of the funds it believes are necessary to meet these needs. In addition, Amtrak plans to use a substantial portion of these funds to meet maintenance needs—needs that have traditionally been considered operating expenses. Finally, recently enacted reform legislation will likely have little financial impact in the short term.

Available Funds May Fall Short of Amtrak's Capital Investment Needs and May Be Used to Pay Maintenance Expenses

Capital investments will continue to play a critical role in supporting Amtrak's business plans and ultimately in maintaining Amtrak's viability. Such investment will not only help Amtrak retain revenues by improving the quality of service but will also be important in facilitating the revenue growth predicted in the business plans. Although Amtrak stands to receive historic levels of federal capital funds in the next few years, it is not likely that sufficient funds will be available to meet Amtrak's identified capital investment needs. Amtrak's September 1997 strategic business plan identified about $5.5 billion in capital investment needs from fiscal years 1998 through 2003.[10] This amount includes such items as completing the high-speed rail program between New York and Boston (about $1.7 billion), making infrastructure-related investments (about $900 million), and overhauling existing equipment (about $500 million). However, federal funding from the Taxpayer Relief Act, the fiscal year 1998 capital appropriation,[11] and the President's proposed fiscal year 1999 budget—along with about $800 million that Amtrak anticipates receiving from state, local, and private financing—would provide about $5.0 billion, or about $500 million short of the $5.5 billion that it states that it needs for capital funding.

Amtrak plans to use a substantial amount of these federal funds for maintenance expenses, such as preventative maintenance, rather than for high-yield capital investments. The use of these available federal funds for maintenance expenses could have long-term financial impacts on Amtrak. In particular, such use would reduce the amount of money available to Amtrak to acquire new equipment and/or acquire those capital improvements necessary to reduce costs and/or increase revenues.

[10]As of mid-March 1998, the capital portion of this business plan had not been approved by Amtrak's board of directors.

[11]The fiscal year 1998 capital appropriation excludes $199 million, which was not to be made available for obligation if Amtrak's reform legislation was enacted before such capital appropriation was distributed. The Amtrak Reform and Accountability Act was enacted in December 1997. The $199 million would have been distributed in July 1998.

In this regard, the President's proposed fiscal year 1999 budget would allow Amtrak to use capital grant funds for maintenance purposes, such as overhauling rail rolling stock and providing preventative maintenance. The administration believes such flexibility would allow Amtrak to manage its capital grant appropriation more efficiently and make clearer trade-offs between maintenance and capital investment costs. Amtrak's March 1998 revised strategic business plan indicates that it plans to use $511 million (82 percent) of the $621 million in capital grant funds proposed in the President's fiscal year 1999 budget for maintenance expenses. In total, Amtrak plans to use $1.8 billion (65 percent) of $2.8 billion in capital grants under the President's budget proposal to pay maintenance expenses from fiscal years 1999 through 2003.

In addition, Amtrak plans to temporarily use some of the Taxpayer Relief Act funds for the allowed maintenance of the existing equipment used in intercity passenger rail service. To help stay within its credit limits,[12] Amtrak plans to temporarily use $100 million in Taxpayer Relief Act funds for a portion of allowed maintenance expenses in fiscal year 1998, according to Amtrak's March 1998 revised strategic business plan. Amtrak's use of a portion of its federal capital grant for maintenance expenses, as is currently allowed for transit, is expected to enable it to repay this $100 million. Amtrak also plans to temporarily use $317 million and $200 million in Taxpayer Relief Act funds in 1999 and 2000, respectively, for a portion of allowed maintenance expenses. In this way, Amtrak expects to reduce its cash flow deficits to $100 million in each of those years. Amtrak officials told us that the Taxpayer Relief Act funds, including these repayments, will ultimately be used for investments that have a high rate-of-return and that are highly leveraged.

According to Amtrak, temporarily using a portion of Taxpayer Relief Act funds for allowed equipment maintenance will help the corporation avoid additional borrowing from its credit lines over the original planned amount. Amtrak believes using Taxpayer Relief Act funds for this purpose will help keep it below its maximum short-term credit limit. Amtrak officials told us that using a portion of the federally appropriated capital grant funds for maintenance will provide stability for Amtrak over the next several years, thus averting a possible bankruptcy. This stability will provide Amtrak with some breathing room to (1) determine how to address the capital shortfall and (2) complete a market analysis that would

[12]As discussed earlier, Amtrak is currently projecting a cash-flow deficit of about $200 million by the end of fiscal year 1998, or about $100 million more than planned.

result in several alternatives for a national intercity passenger rail network.

Short-Term Financial Effects of Amtrak Reform Legislation May Be Limited

The Amtrak Reform and Accountability Act was also designed to address Amtrak's poor financial condition by making certain reforms to Amtrak's operations to help Amtrak better control and manage its costs. For example, the act

- eliminates, as of May 31, 1998, existing labor protection arrangements for employees who lose their jobs as the result of a discontinuation of service (currently eligible employees may be entitled to up to 6 years of compensation) and requires Amtrak and its unions to negotiate new arrangements;
- repeals the statutory ban on contracting out work (except food and beverage service, which can already be contracted out) and makes contracting out subject to negotiations by November 1999; and
- places a $200 million cap on the amount of liability claims (including punitive damages) that can be paid as the result of an Amtrak accident.

The reforms contained in this act may have little, if any, immediate effect on Amtrak's financial performance for several reasons. First, Amtrak officials pointed out that no route closures are currently planned. Therefore, no new labor protection costs are expected to be incurred. Amtrak officials also noted that the existing labor protection arrangements for employees affected by route closures have primarily resulted in payments of wage differentials because many eligible employees were transferred to lower-paying jobs. According to Amtrak, in the past 5 years, only 5 employees have received severance pay and 11 employees are currently in arbitration over this issue. Second, the ban on contracting out work need not be negotiated until November 1, 1999.[13] Amtrak officials believe that while the repeal of the ban may provide long-term flexibility, including flexibility in union negotiations and in controlling costs, the repeal is not likely to have much effect before November 1999. Finally, Amtrak believes the $200 million limit on liability claims may have limited financial effect because this cap is significantly higher than amounts Amtrak has historically paid on liability claims. Amtrak and FRA officials believe the benefits of these reforms are unclear at this time. These

[13]Amtrak and one or more of its trade unions may mutually agree to collectively bargain this issue sooner.

reforms may not result in measurable financial savings as much as in additional flexibility in negotiating with labor unions and in addressing the freight railroads' concerns over such issues as liability payments.

The act also made other changes that have the potential for a significant impact on Amtrak's future. First, the act replaced the current board of directors with a "Reform Board."[14] Second, it established an independent commission—the Amtrak Reform Council—to evaluate Amtrak's financial performance and make recommendations for cost containment, productivity improvements, and financial reforms. If at any time after December 1999 the Council finds that Amtrak is not meeting its financial goals or that Amtrak will require operating funds after December 2002, then the Council is to submit to the Congress, within 90 days, an action plan for a restructured national intercity passenger rail system. In addition, under such circumstances, Amtrak is required to develop and submit an action plan for the complete liquidation of the railroad.

Mr. Chairman, in 1995, we concluded that the Congress needed to decide on the nation's expectations for intercity passenger rail service and the scope of Amtrak's mission in providing that service. These decisions require defining a national route network, determining the extent to which the federal government would contribute funds, and deciding on the way any remaining deficits would be covered. In 1997, we concluded that, as currently constituted, Amtrak will need substantial federal operating and capital support well into the future. Whether Amtrak will be able to improve its financial position in the near term is doubtful. If not, the Congress will be asked to continue to provide substantial sums of money each year to support Amtrak. If the Congress is not willing to provide such levels of funds, then Amtrak's future could be radically different, or Amtrak may not exist at all. We believe that this is the right time for Amtrak's new Reform Board to work with the Congress to consider and act on the issues that will chart Amtrak's future.

[14]The Reform Board is to assume its responsibilities by March 31, 1998, or as soon as four members have been appointed and qualified. As of mid-March 1998, the Reform Board had not been established. Unrelated to the act, Amtrak's president and chief executive officer resigned in December 1997. A successor had not been named as of mid-March 1998.

Mr. Chairman, this concludes my testimony.[15] I would be happy to respond to any questions that you or Members of the Subcommittee may have.

[15]The information contained in this testimony is based on our review of Amtrak's financial reports and plans; recently-enacted legislation; and discussions with Amtrak and FRA officials. We met with Amtrak officials, including Amtrak's Vice President for Government and Public Affairs, to obtain comments on a draft of our statement. Amtrak said that our presentation of the issues was fair; and they asked that we provide additional information on Amtrak's planned use of capital grant funds and Taxpayer Relief Act funds. We have included this information in our statement. We performed our work in March 1998 in accordance with generally accepted government auditing standards.

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